Clark County, Washington

Investment Management Review
Fourth Quarter 1999

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U.S. economic strength continued through the fourth quarter, as evidenced by various stronger-than-expected economic statistics. As a result, many investors remain preoccupied with the potential for growing inflation in the near future. The Federal Reserve has executed a series of preemptive rate hikes in the past few months in order to cool off the economy before any major increases in prices take place. Currently, the Fed Funds target rate is set at 5.75%.

In the fourth quarter, the County shortened the portfolio's average maturity and slightly lowered exposure to market risk. The County also increased the allocation to money market obligations, particularly increasing the total certificates of deposit and Federal Agency discount note holdings in the portfolio. This investment approach modestly improved the diversification of the portfolio by sector and maintained the portfolio's high overall credit quality, liquidity and exposure to call/reinvestment risk. A summary of fourth quarter highlights and PFM's recommendations follow.

- ***Asset Diversification –*** During the fourth quarter, the County increased its allocation of certificates of deposit and Federal Agency discount notes. During the same period, the County decreased the total allocation to the money market accounts by 5.4%. In reviewing the investment portfolio details, it appears that the County purchased a number of the money market securities in October and November, with maturities in the early month of 2000. This enabled the County to capture significant additional yield due to the "Year-End Funding Pressures" and "Y2K" pressures that pushed the short-term rates of securities maturing over the year end higher, as described in last quarter's report. The portfolio remains well diversified among the various sectors.

- ***Maturity Distribution –*** The County's pool portfolio shortened further over the quarter to an average maturity of just over 7 months by the end of December. We would recommend that the County reinvest additional cash out to the 2-year maturity range in order to capture the added yield benefit that currently existing in that very steep area of the yield curve. Our suggested maturity target for the County's portfolio continues to be 9-10 months.

- ***Credit Quality*** – The emphasis on high-quality securities during the fourth quarter maintained the portfolio's low exposure to credit risk. As of December 31, 1999, 82% of the portfolio was invested in securities rated "AAA" (highest long-term rating) or "A-1/P-1" (highest short-term rating), with the remaining assets invested in unrated certificates of deposit or money market funds.

- ***Liquidity –*** As of December 31, 1999, the portfolio maintained a high degree of liquidity with 81% of the portfolio categorized in one of PFM's top three liquidity rating categories (1, 2, and 3). Over the quarter, the overall liquidity factor for the portfolio increased modestly to 3.08 due to an increase in the amount of certificates of deposit in the account, which generally are considered highly illiquid.

- ***Market Risk –*** Mimicking the trend set in the third quarter, the decline in the average maturity of the portfolio and the increase in obligations maturing in 0-3 months slightly lowered the portfolio's exposure to market risk. As of December 31, 1999, 66% of the portfolio maintained low exposure to market risk, compared to 59% as of September 30, 1999.

- ***Callable Exposure*** – The County sustained the same portfolio exposure to call risk during the fourth quarter as in the previous period. As of December 31, 1999, 19% of the portfolio was invested in callable Federal Agencies, in line with PFM's recommended limit.

Fourth Quarter 1999 Economic Summary

Good news for the U.S. economy was bad news for fixed income investors in the fourth quarter. Once again, strong growth drove bond prices lower and depressed returns, and for all of 1999, the fixed income market turned in its worst performance since 1994. Interest rates rose 50-75 basis points through the quarter and year-end aberrations further challenged investors who had to contend with normal funding pressures and Y2K concerns as well.

The good news on the economy was plentiful as the domestic economy approached a record for the longest peacetime expansion. The unemployment rate is at a 30 year low, consumer confidence levels are high, business investment is strong and retail sales continue to fuel demand. Rising stock markets added to individual investors' wealth as major stock indices finished the year at or near all-time highs. Economic recoveries overseas hold out the prospect for growth in worldwide demand for U.S. goods and for food, energy and other basic commodities.

All this good news about economic strength does not bode well for fixed income investments however, as investors grow increasingly wary of potential inflation which erodes their value. As the graph below shows, the yield on the 2-year U.S. Treasury Note rose by nearly two percent over the year, the sharpest increase in five years. Incidentally, investments with maturities of five years and longer generally had negative returns for the entire year, as the decline in their principal value more than offset income.

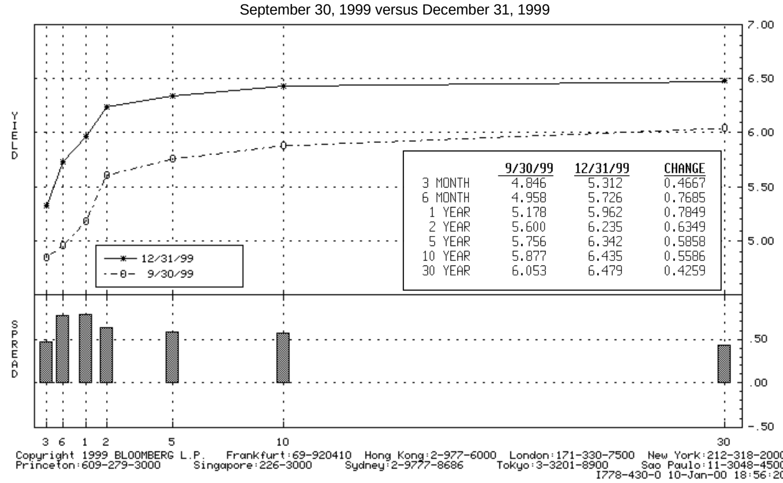
2-Year U.S. Treasury Yield History

January 1, 1994 vs. December 31, 1999

The Federal Reserve raised the Fed Funds rate in mid-November to 5.50%, thus taking back the last element of the ¾ percent stepped reduction it had implemented in the last half of 1998, and putting upward pressure on short-term rates. The increase in longer-maturity yields was somewhat less than that in the short end of the market; the Treasury yield curve flattened somewhat beyond the 2-year maturity range, but steepened from 0 to 2 years, indicating that the market expects short-term rates to continue to trend higher in the near future. Yield spreads on Federal Agency and investment-grade corporate issues, which had been at near record levels during the second quarter, narrowed somewhat after September 30 resulting in better performance for these sectors versus Treasuries. However, spreads on Agencies and corporates remain attractive relative to their historical averages.

U.S. Treasury Yield Curve

September 30, 1999 versus December 31, 1999



The outlook for the economy remains favorable, with most analysts expecting strong growth through the first months of this year, and some raising the specter of rising prices that would force interest rates much higher. Among key indicators:

Gross Domestic Product: The broadest measure of growth, the *Gross Domestic Product (GDP)*, increased at an annual pace of 5.7% for the third quarter, and has averaged 4.3% over the past four quarters, much higher than most economists think is sustainable without putting pressure on prices. Analysts anticipate that fourth quarter *GDP* will also show another large rise, spurred by strong retail sales during the holiday season.

Manufacturing: The manufacturing sector remained strong, as demand both at home and abroad increased for various products. For example, September manufacturing output, as measured by the *National Association of Purchasing Managers (NAPM)*, reached its highest level since November of 1994. Other indicators assessing business inventories and goods orders showed continued manufacturing vigor during the quarter.

Retail Sales: The healthy economic state put many holiday shoppers in a good mood, resulting in consumers spending at record levels. According to the International Mass Retail Association, consumers spent an average of $1,067 on holiday gifts per family, an increase of 10% over last year's average holiday spending. Indeed, on a year-over-year basis, retail sales are up nearly 10%, and the market anticipates strong December sales (to be reported in mid-January).

Crude Oil Futures Prices

January - December 1999

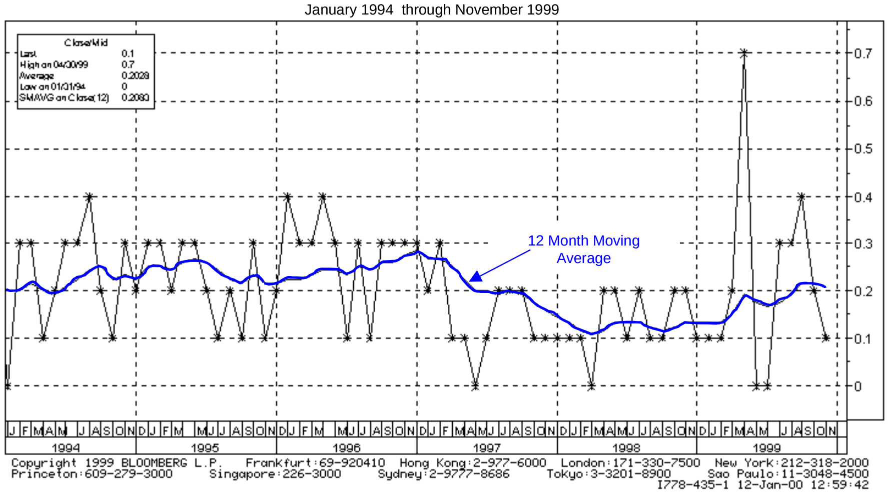
Commodity Prices: Aggregate measures of commodity prices trended higher for most of 1999. In particular, crude oil prices rose sharply, as seen in the accompanying graph, reaching levels last seen in January, 1991. Low commodity prices through 1997 and 1998 were partially credited with keeping inflation in check. Economists worry that such a rise in commodity prices will have a direct upward push on the overall price levels in the economy.

Employment: The unemployment rate dropped 0.1% to 4.1% in October, a 30-year low. The economy continues to add new jobs: over 220,000 workers in November and another 315,000 in December. The December report also showed a much higher than expected rise in the average hourly pay of 6 cents, or 0.4%, giving support to the theory that tight labor market lead to wage inflation, which may subsequently be passed through as higher prices. The *Productivity and Cost* report for the 3rd quarter, released by the Labor Department early in the quarter, indicated that worker productivity rose at a pace of 4.2%, a big increase from the 0.6% increase in productivity reported for the second quarter. Such news reinforces the notion that much of the economy's strong growth with limited inflation is largely credited to increased productivity due to technological advances, and helps offset some of the implications regarding the tightness of the job market.

Prices: Prices remained in check for most of 1999, although both the *Producer Price Index (PPI)* and *Consumer Price Index (CPI)* began a modest upward tend in the quarter. Over the past 12 months, CPI increased by only 2.6%, while the overall PPI increased by 3.1%. Over the same period, the core PPI was up by less than 1%. Although these levels are low relative to historic levels, some analysts worry about the upward trend.

Change in Consumer Prices

January 1994 through November 1999



Federal Reserve monetary policy remains key to short-term interest rates, and the outlook for inflation is key to long term rates. After raising the Fed funds rate by 0.25% in November, the Fed left rates unchanged at their December 21 meeting and announced a neutral outlook on the future direction of interest rates. Many analysts ignored this announcement as simply a tactic on the Fed's part not to disrupt the markets immediately before "Y2K."

Rising inflation, signaled by rising CPI, PPI and wages rates, could lead to sharply higher long term rates and a steepening of the yield curve. In this scenario, longer-term Treasury yields could punch through 7% and the yield curve could steepen to compensate investors for taking return risk inherent in long term investments.

In either case, the year 2000 begins on a bearish note, with many investors convinced rates will move higher, and waiting for signs of how much and how soon they move. Until there are definitive signs of a slowing in the pace of economic growth, this pall is likely to remain over the markets. However, with interest rates at their highest levels since mid-1997, there are also significant opportunities to enhance income through prudent choice of investments.

Current Market Overview

The U.S. economy expanded at an annual rate of 5.8% during the fourth quarter, according to the first estimate of the *Gross Domestic Product (GDP)* by the Commerce Department. The start of February was also the start of the 107th consecutive month of economic expansion, setting a record for the longest peace-time economic expansion in U.S. history. The continued strength of economic data indicates that the domestic economy is continuing to expand, leading analysts to speculate that the Fed will continue to tighten short-term rates.

An assessment of the economy is provided below:

- ***Inflation*** – Prices, as gauged by the *Consumer Price Index and Producer Price Index* remain benign. Producer prices rose by 0.3% in December according to the *PPI* release, with the core *PPI*, which excludes the more volatile food and energy prices, increased by only 0.1%. For the same month, consumer prices increased by only 0.2% according to the *CPI* release, with the core *CPI* showing an increase of only 0.1%. Many analysts are concerned that the continuing rise in commodity prices, in particular of crude oil, will exert an upwards pressure on prices and lead to an inflationary environment.

- ***Employment*** – Employment data remains very strong, a sign that the economy is not slowing down yet. According to the latest data released on February 4, the *Unemployment Rate* notched down to 4.0% for January, a 30-year low. The same report also showed that an additional 387,000 jobs added to the economy over the month, exceeding analysts' expectations.

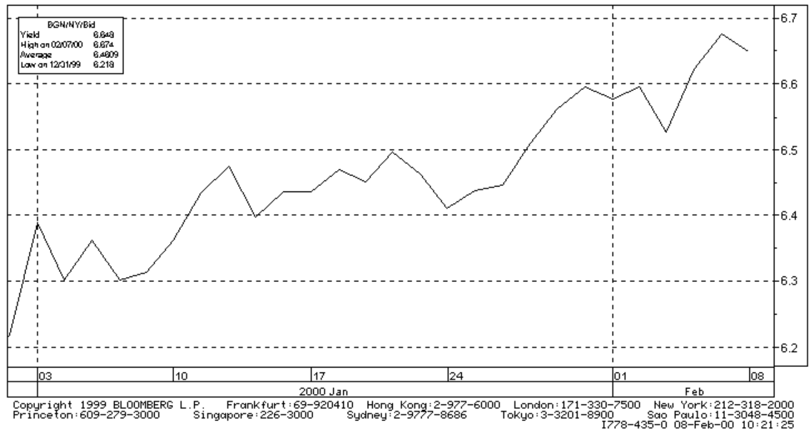
- ***Manufacturing*** – The manufacturing sector remains strong. According to the Commerce Department, *Factory Orders* rose by 3.3% in December, the largest monthly increase in 7 years. On an annual basis, orders at U.S. factories grew by 6.6% for 1999.

- ***Home Sales*** – *Housing Starts* rose by 7.1% for December, a much higher than expected pace. Total *Starts* for 1999 were at 1.663 million units, the highest since level since 1986. Buyers do not appear to be deterred by rising mortgage prices, but rather encouraged by the strength of the economy and low unemployment rates.

- ***Monetary Policy*** – The Fed raised short-term rates again by 0.25% at their February 1-2 FOMC. The current Fed Funds target rate now stands at 5.75%. The Fed also noted that they continue to see "heightened inflationary pressures" reflecting a change in FOMC procedures which eliminates the announcement of the Fed's "bias' on future interest rates.

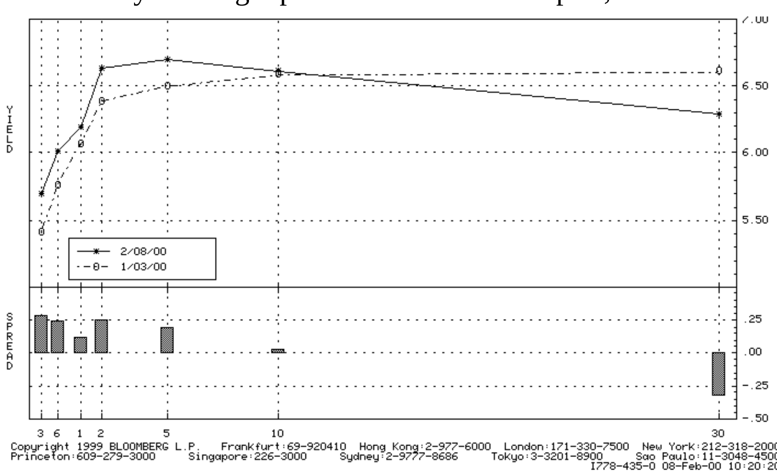
Intermediate-Term Rates

Intermediate-term rates continued to trend upwards since the beginning of the new year. The Fed did raise short-term rates again after their February 1-2 meetings, which also gave intermediate-term rates an upwards push. The chart to the right illustrates the rise in the yield of the 2-year U.S. Treasury note since the beginning of the year.



Current Yield Curve

The U.S. Treasury yield curve has taken on an unusual shape in the past few days, becoming inverted in the intermediate- to longer-maturity range. Two year Treasury Notes are currently yielding more than 30-year Treasury Bonds. Typically, longer-term securities yield more to compensate investors for the additional risk they take on by locking in their money for longer periods of time. In the past, an inversion of the yield curve typically has signaled the beginning of a an economic slowdown. The current inversion of the curve is seen as a technical effect of supply and demand, spurred on by the Treasury's announcement that it will further decrease its issuance of long-term debt and the start of its buy-back program of U.S. Treasuries with maturaties out beyond 10-years. These actions will decrease the overall supply of longer-term Treasury obligations in the market.



Sector Distribution

In the fourth quarter, the County's portfolio continued to be well diversified. Among short-term securities, the County increased their holding of certificates of deposit and Federal Agency Discount Notes while slightly decreasing the commercial paper and money market fund holdings. Since short-term rates tend to spike up towards the end of each year due to "year-end funding pressures," the County was able to lock in attractive yields that were higher than those of a money market fund. The table below illustrates the sector composition of the County's pool portfolio as of December 31, 1999, compared to September 30, 1999 and December 31, 1998.

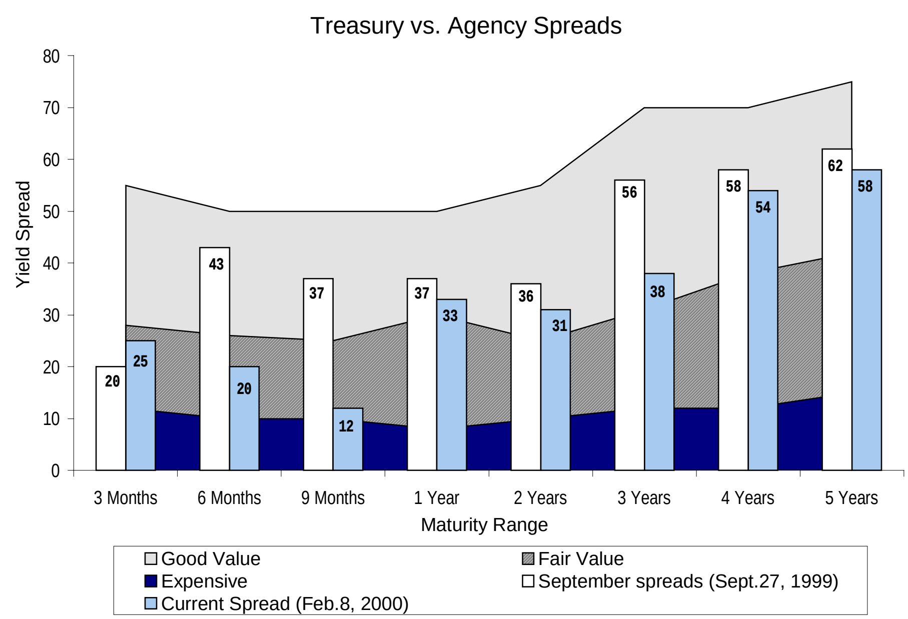
Sector Composition Comparison

	12/31/1998	9/30/1999	12/31/1999	Quarter Change
Bankers Acceptances	0.0%	1.3%	1.3%	0.0%
Certificates of Deposit	1.5%	2.5%	7.8%	5.2%
Commercial Paper	11.8%	13.4%	9.6%	(3.8%)
Federal Agency Discount Notes	8.8%	1.3%	5.2%	3.9%
Federal Agency Notes	44.3%	50.6%	49.2%	(1.4%)
Treasury Securities	7.4%	7.6%	9.1%	1.5%
Passbook/Money Market Accts	26.2%	23.3%	17.9%	(5.4%)
Totals	**100%**	**100%**	**100%**	

*Based on par values of securities in pool portfolio.

*Note change in methodology – report compares assets in the "Pool" portfolio only. The values for the prior periods have been revised to reflect this change in method.

In the third quarter report, we suggested that the County increase gradually its allocation to the Treasury sector. It appears that the County has executed trades to accomplish this. As the chart to the right shows, Treasury to Agency yield spreads have recently narrowed across the curve. Given the current market, we would suggest that the County continue to increase its overall allocation to Treasuries, targeting a range of 20%-25%. Events in the market could lead to a future yield spread widening, providing the opportunity to then swap Treasury securities acquired at current yields for Agencies to capture additional earnings due to the change in yield spreads. Maintaining a combination of both Federal Agency and Treasury securities in the portfolio may allow for additional swap opportunities over the next few months.

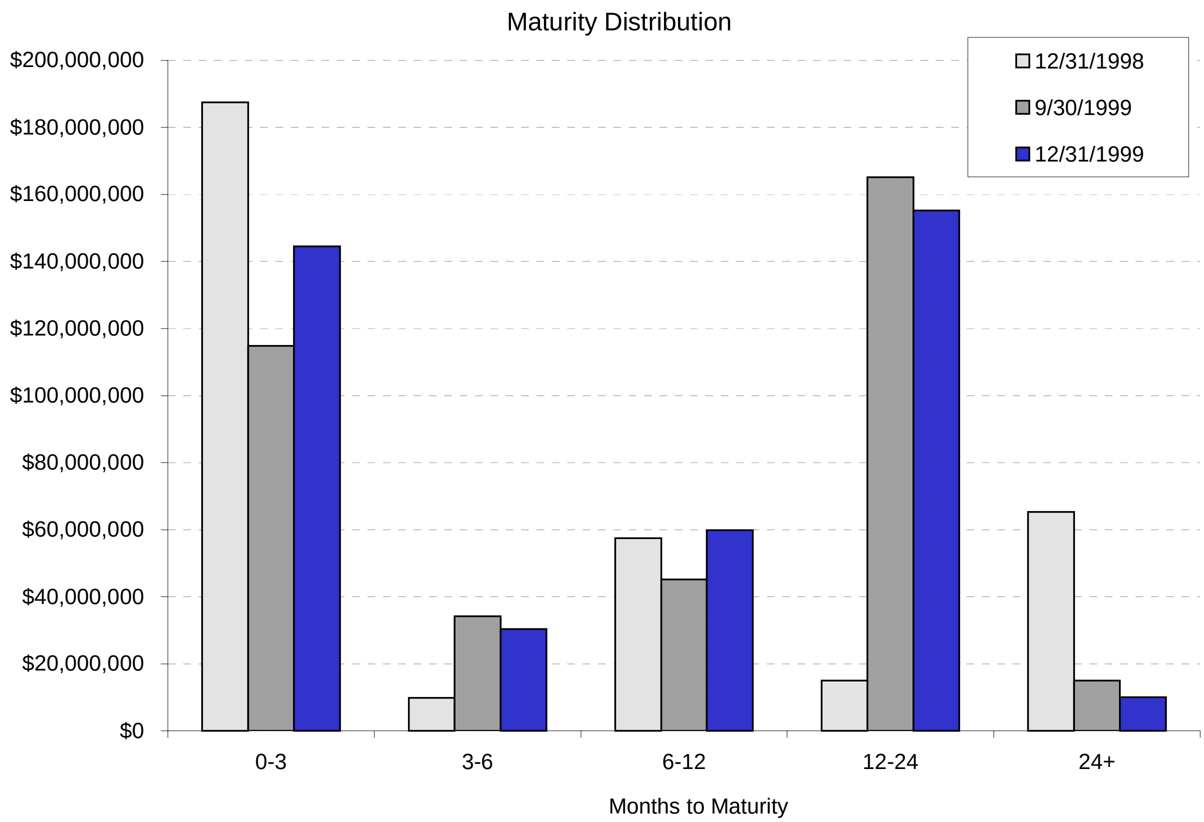


As of December 31, 1999, 14% of the County's portfolio was invested in State LGIP and another 3.5% was invested in the Bank Municipal Investor account. As described in last quarter's report, the State LGIP provides daily liquidity and a competitive short-term rate of return generally commensurate with rates offered by overnight to 30-day money market securities. However, during periods when short-term rates are rising, money market funds such as the LGIP lag the market because a portion of the underlying portfolio of securities was purchased at previously lower rates. Therefore, since the Federal Reserve again raised short-term rates on February 2, we recommend redirecting assets invested in the LGIP that are not needed for immediate liquidity into short-term money market instruments to take advantage of the higher yields offered by these securities.

Maturity Distribution

The portfolio shortened over the quarter, with a large portion of the total portfolio assets concentrated in the 0-3 month maturity range. The portfolio average maturity decreased to 7 months (220 days) as of December 31, 1999 from an average maturity of 9 months (278) days as of September 31, 1999.

The chart below illustrates the maturity distribution of the County's portfolio as of December 31, 1999, compared to September 30, 1999 and December 31, 1998.



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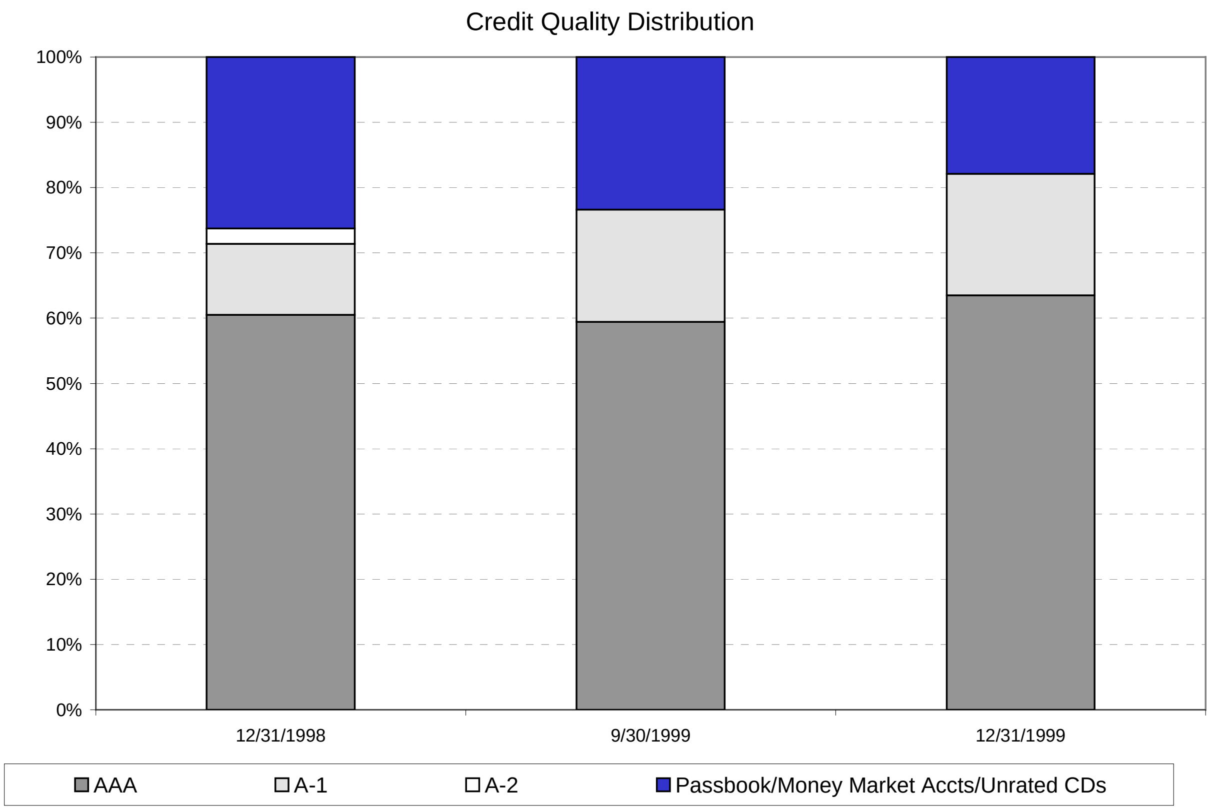
The yield curve remains particularly steep in the 1-2 year maturity range. As of February 10, a Federal Agency maturing in two years yielded approximately 7%, while a comparable Federal Agency security with a maturity of 1 year yielded a 6.40%. At these levels, the 2-year represents good value. Therefore, we continue to recommend targeting new investments to the 2-year area to capture the roll-down-the-curve benefit and to enhance investment returns. Further, this strategy will help to lengthen the portfolio's duration.

With the recent increase in short-term rates by the Federal Reserve, we would suggest that the County invest any funds that are not necessary for immediate liquidity, in the 30-60 day maturity range to capture the higher yields than available in the money market and LGIP funds, as described in the previous section of this report.

Credit Quality

The County's investment strategy maintained the overall high credit quality of the portfolio through the fourth quarter. As of December 31, 1999, 82% of the portfolio was invested in obligations rated "AAA" or "A-1/P-1", with the remainder primarily invested in the State LGIP. This sustained the portfolio's low exposure to credit risk.

The chart below shows the credit quality distribution of the portfolio as of December 31, 1999, compared to September 30, 1999 and December 31, 1998.

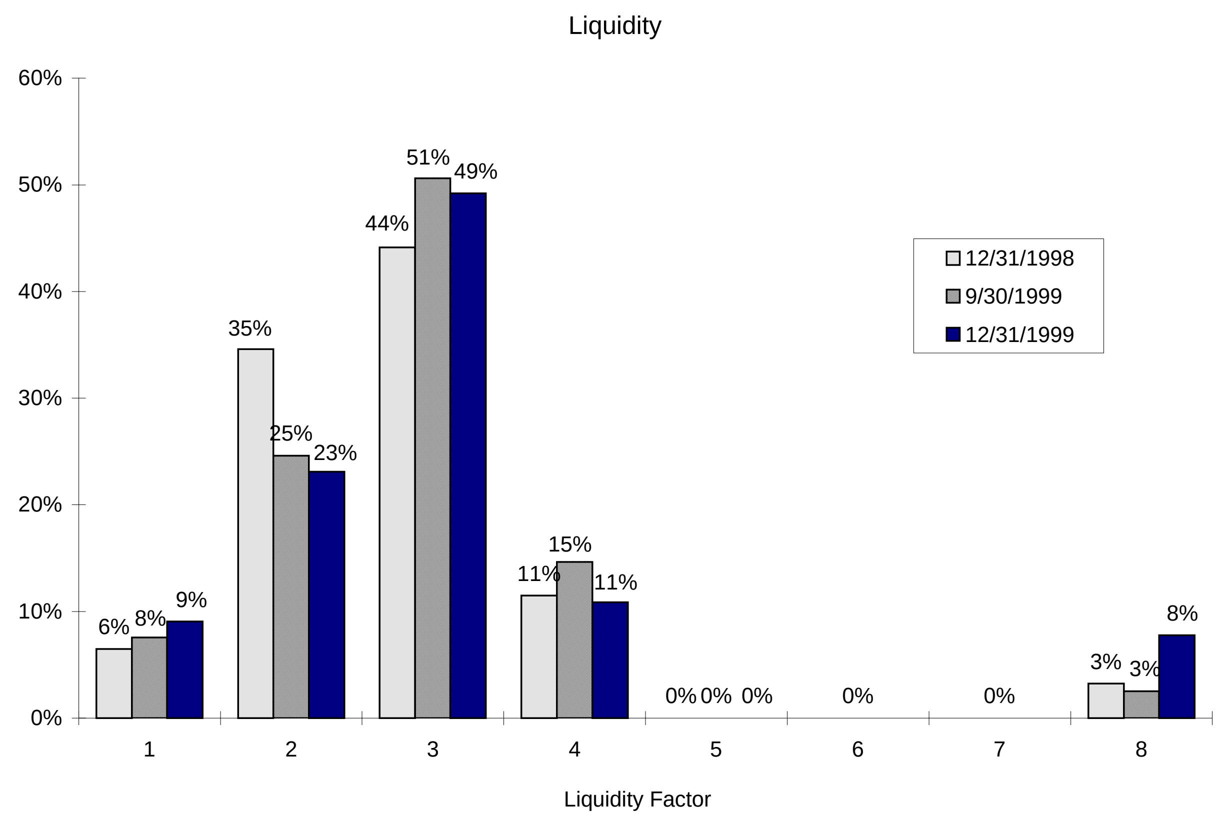


*Note change in methodology – report compares assets in the "Pool" portfolio only. The values for the prior periods have been revised to reflect this change in method.

Liquidity

The County's portfolio remains highly liquid. As of December 31, 1999, 92% of the portfolio was invested in obligations rated among one of the four highest liquidity rating categories (1, 2, 3, and 4). The average weighted liquidity of the portfolio was 3.08 as of the quarter-end. The slight increase in the average weighted liquidity stemmed from an increase in the certificate of deposit holdings in the portfolio, which fall into an illiquid category 8. Overall, the portfolio remains within PFM's recommended liquidity range of 2 to 4.

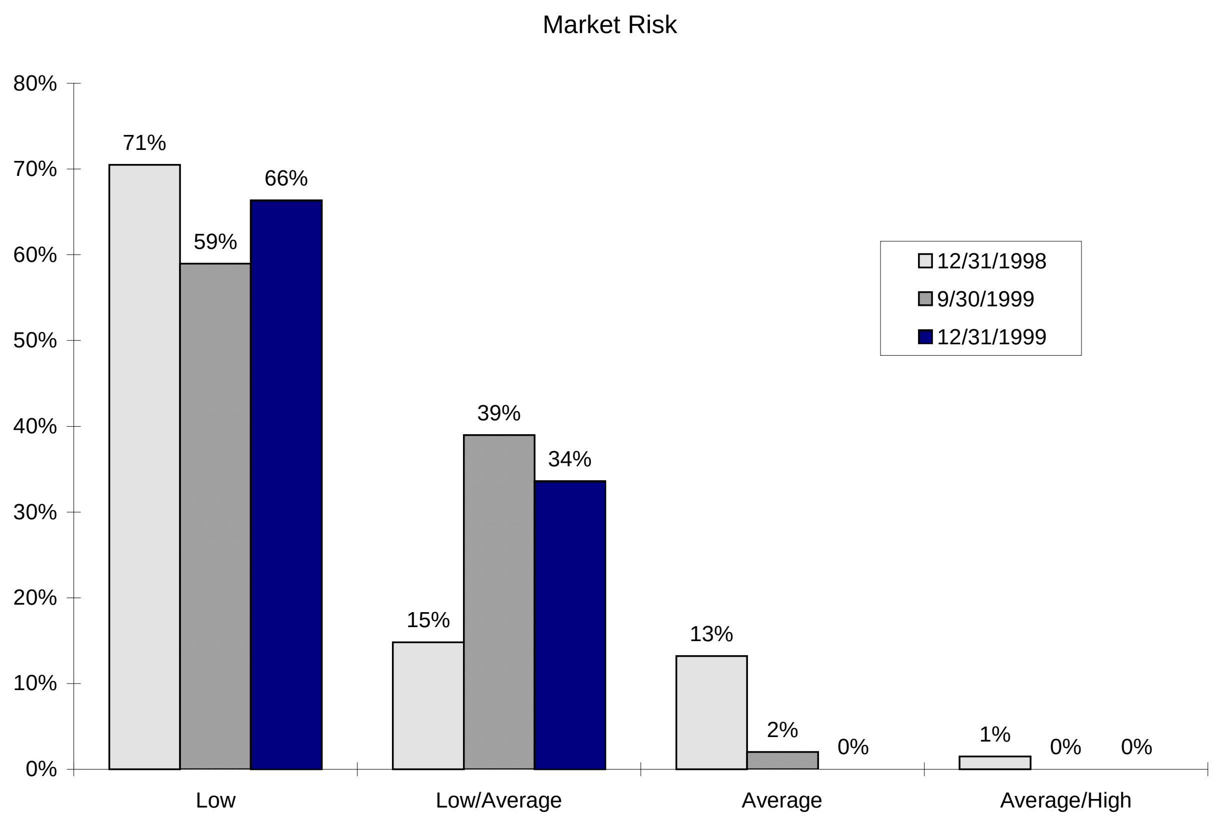
The chart below shows the liquidity distribution of the portfolio as of December 31, 1999, compared to September 30, 1999 and December 31, 1998. Category 1 represents securities that can be easily sold with little difference between the bid and offer prices, such as U.S. Treasuries. Category 8 represents securities that are generally considered illiquid such as non-negotiable certificates of deposit.



*Note change in methodology – report compares assets in the "Pool" portfolio only. The values for the prior periods have been revised to reflect this change in method.

Market Risk

The County continued to increase its short-term holdings during the fourth quarter, and therefore decreased the portfolio's exposure to market risk. Since the entire portfolio, as of December 31, 1999, matured in under two years, 100% of the portfolio was invested in obligations categorized as maintaining low or low/average exposure to market risk. The chart below shows the portfolio's exposure to market risk as of December 31, 1999, compared to September 30, 1999 and December 31, 1998.



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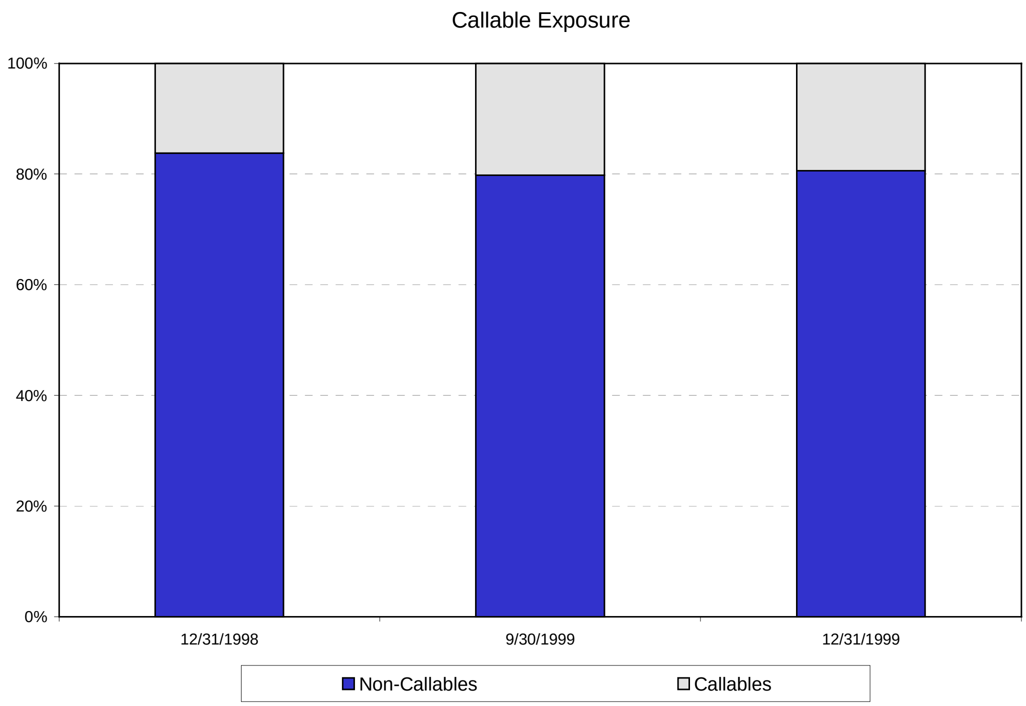
Call Exposure

The portfolio's allocation to callable obligations remained virtually unchanged through the quarter. As of December 31, 1999, 19% of the portfolio was invested in callable instruments, compared to 20% as of September 30, 1999. PFM believes this level of call risk is appropriate for a portfolio of this size and nature.

The chart below indicates the portfolio's call exposure as of December 31, 1999, compared to September 30, 1999 and December 31, 1998.



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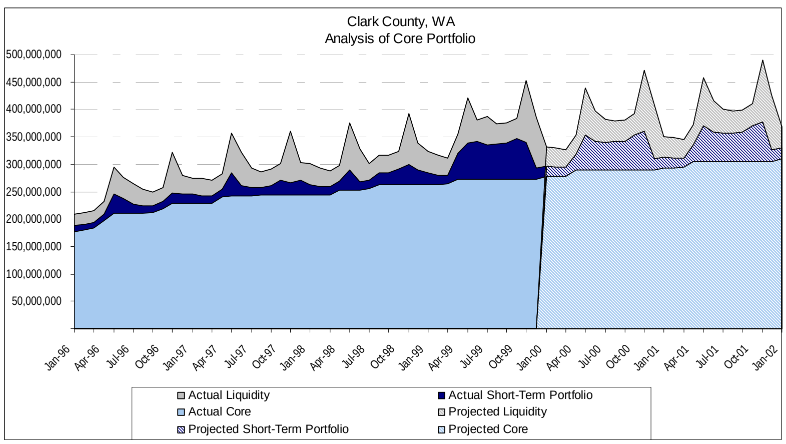
PFM has developed a cash flow model to assist it clients in analyzing historical trends and seasonal fluctuations. The resulting analysis allows us to determine the optimal portfolio mix between short-term liquidity instruments (e.g., the LGIP and money market instruments) and longer-term securities (U.S. Treasury notes and Federal Agency notes). The model also helps to determine how much of the portfolio can be invested in longer-term securities to enhance yield.

We have used the model to analyze the change in the average balance of the Clark County Investment Pool from January 1996 to December 1999. The results are shown in the chart below. The data on the left side represents actual historical data. The data on the right side represents projected balances. Projections are based on historical seasonality[1] and a 5% annual growth rate.

The portfolio is allocated among the following three components: 1) Liquidity – representing funds needed to cover cash needs in the upcoming month. These funds are to be invested in very short-term money market instruments and the State LGIP. 2) Short-term portfolio – this includes funds set aside to provide liquidity for anticipated disbursements in two to six months and an added cushion should liquidity requirements suddenly increase. And 3) Core – this represents the portion of the portfolio that could be invested in longer-term obligations to achieve higher rates of return over the long run.



As reflected by the chart, the County's portfolio balance predictably reaches its peaks in May and November and its low points in March and September. The results of this analysis suggest that the portfolio will experience a net cash outflow during the first quarter. Therefore, the County will need to maintain an adequate portion of its portfolio in short–term securities to cover the monthly disbursements. At the same time, the County's core portfolio continues to increase in size. Therefore, the County may be able to reinvest a portion of the pool out further in maturity to move the portfolio back to the target 9-10 month maturity range from its December average portfolio maturity of 7 months.

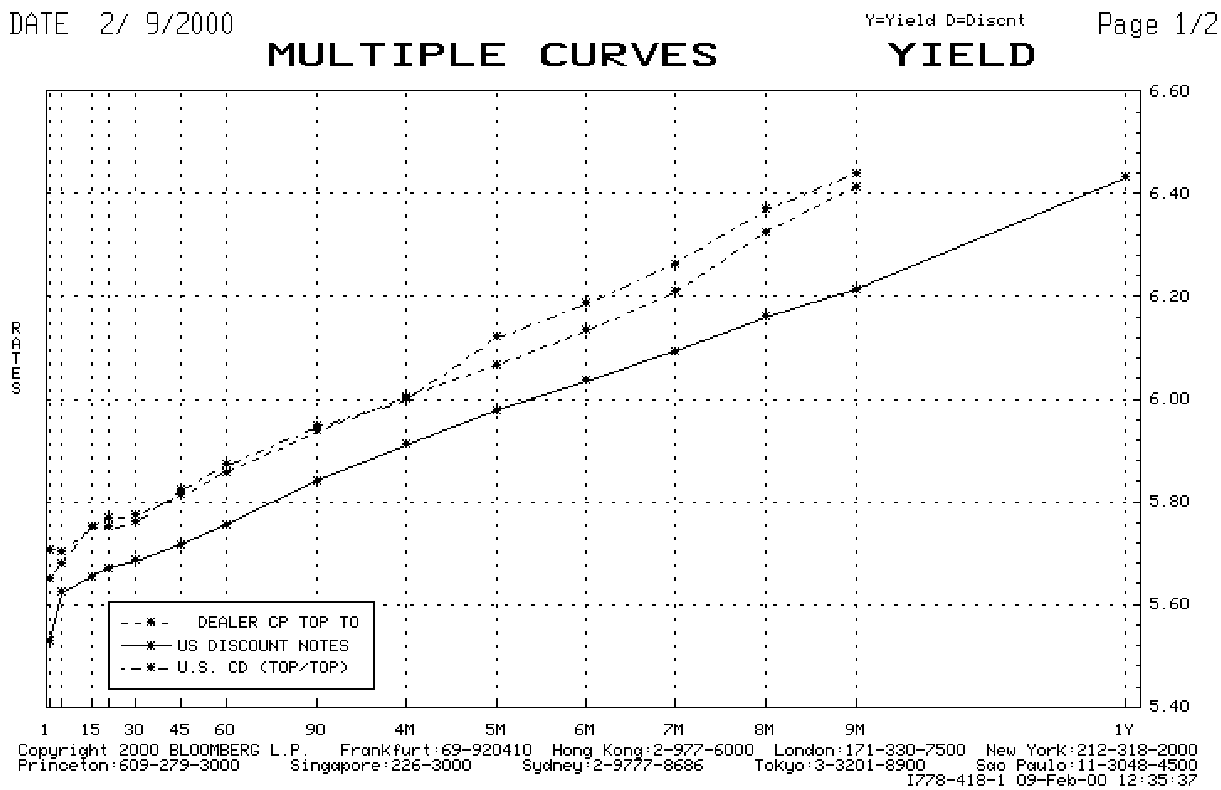
[1] A predictable change in the monthly balance from year-to-year due to the timing of cash inflows and outflows.

The table below illustrates the current yield spreads and the 6-month average spreads of various short-term securities as compared to U.S. Treasury Bills in the same maturity range. The table also provides an evaluation and current outlook of our portfolio managers on the short-term market. Since the County needs to maintain a high degree of liquidity in its portfolio, this may serve as an additional reference for evaluating trade opportunities in the current market.

REVIEW OF INVESTMENT SECTORS

	Sector Spreads to U.S. Treasuries Bills									
	60-90 days		120-180 days		180-270 days		360-450 days			
Sector	2/7/00	6 mo. Avg	2/7/00	6 mo. Avg	2/7/00	6 mo. Avg	2/7/00	6 mo. Avg	Current Evaluation	Observations
US Treasury Bills	5.61		5.92		6.12		6.20			
Agency Discount Notes	0.27%	0.44%	0.17%	0.46%	0.11%	0.40%	0.19%	0.46%	FAIR / HOLD or BUY	The Agency Discount Note yield curve reflects another 25 basis point Fed rate hike during 1st half 2000.
Non-callable	0.30%	0.45%	0.20%	0.46%	0.12%	0.47%	0.35%	0.46%	FAIR - CHEAP / HOLD or BUY	Short-term Coupons are still somewhat cheaper than Federal Agency Discount Notes.
Callable (1yr/3month)							0.45%	0.56%	FAIR – EXPENSIVE/ HOLD	Callable securities have gotten cheaper lately.
Bankers Acceptances	0.27%	0.52%	0.20%	0.48%					EXPENSIVE / HOLD	Very expensive versus Discount Note rates currently.
Commercial paper	0.39%	0.61%	0.31%	0.60%	0.05%	0.58%			FAIR/ HOLD or BUY	CP curve is moderately cheap and offers value in the 3-6 month range.
Negotiable CD's	0.37%	0.60%	0.30%	0.59%	0.36%	0.64%	0.53%	0.60%	FAIR / HOLD or BUY	CDs greater than 6 months offer good relative value.
Repurchase Agreements (Term)	0.37%		0.30%							Short-Term Repo rates are in-line with yields on Agency discos

In addition to monitoring historical spread relationships as presented in the table above, it is also important to consider the steepness of the yield curves of the various short-term securities relative to the current economic conditions. Below, we have presented the current yield curves for A1+/P-1 commercial paper, U.S. discount notes and A1+/P-1 certificates of deposit to serve as an additional resource in evaluating trade opportunities in the current market.



	DEALER CP TOP TOP	US DISCOUNT NOTES	U.S. CD (TOP/TOP)
	Yield	Yield	Yield
1 DAY	5.70000	5.53000	5.65000
7 DAY	5.70000	5.62000	5.68000
15 DAY	5.75000	5.65000	5.75000
21 DAY	5.77000	5.67000	5.75000
30 DAY	5.77000	5.68000	5.76000
45 DAY	5.82000	5.71000	5.82000
60 DAY	5.86000	5.76000	5.87000
90 DAY	5.94000	5.84000	5.95000
4 MONTH	6.01000	5.91000	6.00000
5 MONTH	6.07000	5.97000	6.12000
6 MONTH	6.14000	6.04000	6.19000
7 MONTH	6.21000	6.09000	6.26000
8 MONTH	6.32000	6.16000	6.37000
9 MONTH	6.41000	6.21000	6.44000
1 YEAR		6.43000	

Currently, the yield curves are relatively steep, suggesting that an investor may benefit from extending out the short-term securities out in maturity by picking up significant additional yield. For example, 9-month commercial paper had a yield of 6.41% as of February 9th, compared to a yield of 5.94% on 3-month commercial paper, a difference of 47 basis points.

In analyzing a yield curve, we often discuss the steepness of the curve at various maturity ranges to identify areas of particular value. Under a typical interest rate environment, the yield curve tends to be upward sloping, with yields increasing as the time to maturity lengthens. This occurs because investors typically expect to be compensated more to lock in their money for a longer period of time. The further you extend in maturity, the smaller the difference in yields becomes since the risk of locking in your money for 10 years versus 15 years is less significant than whether you lock your money in for 3 months versus 2 years.

Our trading room has developed an approach to quantify the value added of investing in longer-term securities along the yield curve. The analysis compares the amount of additional yield that is picked up by purchasing a longer security in relation to how much added risk the investor takes on by locking in the money further into the future. The table below presents the results of this analysis:

Maturity	Duration	Yield	Spread over Risk-Free	Yield Value per Unit of Duration
3-month *	0.25	5.66		
6-month	0.48	5.99	0.33	0.68
1-year	0.95	6.19	0.53	0.55
2-year	1.82	6.70	1.04	0.57
3-year	2.62	6.78	1.12	0.43
5-year	4.02	6.76	1.09	0.27
10-year	6.89	6.61	0.95	0.14
30-year	13.12	6.19	0.53	0.04

*The 3-month T-Bill is considered the "risk-free" yield.

Analysis as of February 9, 2000; yields and duration source: Bloomberg.

The first two columns of the table above show the duration of different Treasury securities and current yield. The column entitled “Spread over Risk-Free” simply shows the additional yield gained by investing in longer-term maturities by subtracting each security’s yield from the yield on the 3-month Treasury Bill (considered the “risk-free” rate). The final column divides this spread, or difference in yields, by the duration of each particular security to determine the added yield value in relation to the extended duration.

Because duration is a measure of market risk, this analysis helps to quantify risk versus return along the yield curve. Presently, the 6-month and 2-year maturity ranges offer the greatest value.

Provided below is a summary of PFM's recommendations for the fourth quarter 1999:

- **Gradually increase allocation to U.S. Treasuries.** As explained in the sector distribution section of this report, the difference in yields between Treasuries and Federal Agencies has narrowed over the past several weeks. Selected treasuries now represent reasonable value and we would recommend that the County increase its overall allocation to Treasuries to a range of 20%-25%. This strategy will position the portfolio to swap those Treasuries back into Federal Agencies if spreads widen. In addition, Treasuries do outperform Federal Agencies in certain quarters so maintaining a greater diversification among the two sectors may prove beneficial on a total return basis for the County.

- **Maintain allocation to Federal Agency obligations.** Yield spreads between U.S. Treasuries and Federal Agencies remain wide over much of the curve. For this reason, we continue to recommend that the County maintain a sector allocation target of 45% - 55% to the Federal Agency sector. As shown in the matrix of Investment Sectors, short-term non-callable Federal Agency coupon Notes currently are somewhat cheaper than Federal Agency discount notes in the same maturity range. This may be one sector that the County may want to evaluate when making investment choices in the shorter maturity range.

- **Consider increasing use of money market securities due to recent Fed's rate increase.** The Federal Reserve raised short-term rates again, increasing the current Fed Funds target rate to 5.75%. Money market funds, such as the State LGIP, tend to lag the market. Therefore, as short-term rates continue to climb, we recommend redirecting funds invested in the LGIP to short-term money market securities to continue to enhance returns.

- **Maintain portfolio average maturity within 9-10 months.** During the fourth quarter, the County continued to shortened the average maturity of the portfolio from 9 months to 7 months. Considering the current interest rate environment, we suggest that the County maintain the average maturity of the portfolio within the target range of 9-10 months by systematically reinvesting maturities out the yield curve. This strategy will allow the County to benefit from the higher interest rates offered by longer-term obligations and the increase in market value generated by the roll-down-the-curve effect.

- **Take advantage of steepness of the short-term yield curve.** An analysis of the County's anticipated cash flow requirements suggests that the pool balance declines through February and March. The analysis also shows that there is approximately $15-$20 million that could be invested in the 3-month and 9-month maturity range in order to capture some of the yield benefit available out in that area.

- **Maintain allocation to callables.** As of December 31, 1999, 19% of the County's portfolio was invested in callable Federal Agency securities. As noted, PFM believes this is an appropriate level of call exposure. However, we do not believe that yields currently offered by higher-coupon callables are compensatory for the added call risk. Therefore, PFM recommends that the County continue to replace callable securities that are called or that mature with either non-callable obligations or low-coupon callables, which should provide better call protection given their nominal interest rate.

- **Continue to avoid Japanese bankers' acceptances.** The Japanese Yen had significantly gained in value against the U.S. Dollar over 1999, but in recent weeks, the U.S. Dollar has been on the rebound against the Yen, reaching a five-month high on February 8. Some concern has surfaced that the Japanese economy may have begun slipping back into a recession in the last months of 1999 after beginning an economic recovery earlier in the year. We believe it will be some time before credit quality of Japanese financial products will be appropriate for public funds investment.

The sector and maturity composition recommendations below are based on our current market assessment and recommendations, the County's investment objectives and limitations imposed by the County's investment policy.

Investment Sector	Recommended Average Maturity	Current Average Maturity	Recommended % of Portfolio	Current % of Portfolio
U.S. Treasury Obligations	9 months - 1.5 years	0.87 Years	20% - 25%	9%
Federal Agency Notes/Discount Notes	6 month - 1.5 years	0.93 Years	45% - 55%	54%
Commerical Paper, Certificates of Deposit, Domestic Banker's Acceptances, State Pool	10 - 40 days	16 Days	15% - 35%	37%
Aggregate Average Maturity	**9-10 months**	**7.2 Months**		